Supreme Court, U.S.
FILED

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03 - 59 JUL 2 2003
No. 03-

IN THE

Supreme Court of the United States

BAXTER INTERNATIONAL, INCORPORATED,
Petitioner,

v.

ABBOTT LABORATORIES,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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146 pp

QUESTION PRESENTED

Whether an arbitration panel may shield its award from court review for compliance with public policy because the panel itself concluded that the award does no violence to a specific public policy favoring competition embodied in the antitrust laws?

CORPORATE DISCLOSURE STATEMENT

Petitioner Baxter International, Incorporated has no parent company and no publicly held corporation owns 10% or more of Petitioner's stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Baxter International, Incorporated respectfully requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit was entered on January 16, 2003 and is included in the Appendix ("App.") at 1a-18a. It has been officially reported and can be found at *Baxter International, Inc.* v. *Abbott Laboratories*, 315 F.3d 829 (7th Cir. 2003). Baxter's petition for rehearing en banc was denied on April 10, 2003. The order denying the petition and the dissenting opinion accompanying that order are included in the Appendix at 92a-94a. They, too, were officially reported and can be found at *Baxter International, Inc.* v. *Abbott*

Laboratories, 325 F.3d 954 (7th Cir. 2003). The March 27, 2002 opinion of the district court is not reported, but is reproduced in the Appendix at 19a-42a.

JURISDICTION

The court of appeals entered its opinion and judgment on January 16, 2003. Petitioner timely filed its petition for rehearing en banc on January 30, 2003. That petition was denied on April 10, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

TREATY PROVISION INVOLVED

The arbitral award in this case falls within the scope of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *done* June 10, 1958 (entered into force for the United States Dec. 29, 1970) ("New York Convention"), which is reproduced in the notes to 9 U.S.C. § 201. Article V, § 2(b) of the New York Convention provides:

> Recognition and enforcement of an arbitral award may ... be refused if the competent authority in the country where recognition and enforcement is sought finds that ... [t]he recognition or enforcement of the award would be contrary to the public policy of that country.

STATEMENT OF THE CASE

This Court has long recognized that public policy is a significant constraint on the enforceability of arbitration awards. See *W.R. Grace & Co.* v. *Local Union 759*, 461 U.S. 757 (1983). Courts asked to approve such awards have routinely declined to do so when the ultimate effect of the arbitration decision conflicts with federal law (here, the antitrust laws) and thus does violence to public policy norms. To be sure, courts are not free to use public policy as an

excuse for setting aside awards with which they disagree; that would invade the province of the arbitral process. By the same token, until the decision in this case, arbitrators were not authorized effectively to preempt judicial scrutiny of the consistency between their awards and public policy as embodied in federal law by purporting to decide that issue as part of the arbitration. The Seventh Circuit abdicated its responsibility to ensure that public policy is not vitiated by private arbitrators. This fundamental departure from the rulings of this Court and the courts of appeals warrants certiorari.

A. The Sevoflurane Agreements.

This case concerns Petitioner's effort to market a generic version of a successful inhalable anesthetic, sevoflurane, in competition with Abbott Laboratories' ("Abbott's") brand-name product. Petitioner invented sevoflurane in the mid-1960s, but no commercially viable process for producing it existed until the early 1980s when Petitioner obtained patents on the "one-step process" for making sevoflurane. App. 1a. Petitioner then licensed its patents on both the sevoflurane molecule and the one-step process to a Japanese company, Maruishi, so that Maruishi could obtain regulatory approval to market sevoflurane in Japan and other Asian countries. In the early 1990s, Maruishi, having obtained regulatory approval, introduced sevoflurane in Japan, where the product was a commercial success.

Petitioner and Maruishi then turned their attention to the United States. Maruishi decided not to introduce sevoflurane in the United States itself, opting instead to sublicense its rights to Respondent Abbott Laboratories. In 1992, after lengthy and detailed negotiations, Petitioner entered into a new licensing agreement with Maruishi, which gave Maruishi the right to grant sublicenses, and Maruishi entered into a separate sublicensing agreement with Abbott.

Because Petitioner's patents on sevoflurane itself and the method of using it as an anesthetic had expired in 1989, that product and method were already in the public domain by 1992. *Dastar Corp.* v. *Twentieth Century Fox Film Corp.*, 123 S. Ct. 2041, 2048 (2003) ("'the right to make [an article whose patent has expired] – including the right to make it in precisely the shape it carried when patented – passes to the public'") (alteration in original) (quoting *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U.S. 225, 230 (1964)). As a result, the 1992 license and sublicense could not and did not convey rights to sevoflurane itself or to its use as an anesthetic. Instead, the license and sublicense conveyed rights only to the one-step process patents and related know-how. The parties thus were fully aware that Abbott could face competition for the sale of sevoflurane in the United States, even before the licensed patents expired in 2005, from generic producers who developed processes for producing sevoflurane that did not infringe the one-step process patents. Indeed, Abbott expressly anticipated and planned for such competition to arrive by 2000.

Although Petitioner and Abbott did not enter into any license agreements with each other, both Petitioner and Abbott along with Maruishi (and a fourth party not relevant to these proceedings) entered into a separate Dispute Resolution Agreement. That agreement provided that, if a dispute arose under the sevoflurane agreements, the parties agreed first to negotiate, then to mediate, and finally, if necessary, to arbitrate. App. 105a-107a. In the event arbitration became necessary, the agreement expressly set a standard to guide the conduct of the arbitrators. They should strive to prevent an "Impairment of the Original Commercial Relationship." *Id.* at 97a. This "Impairment of the Original Commercial Relationship" was defined to include "an alleged breach or termination of one of the Sevoflurane Agreements that results or could reasonably be expected to result in any change or potential change in the Original Commercial Relationship that

would ... reduce the amount a party would but for such change otherwise receive under any Sevoflurane Agreement." *Id.* at 97a-98a. In discharging that duty, the arbitrators were directed to employ "sound and impartial business judgment," which is also what the agreement directed executives of the parties to employ during pre-arbitration negotiations concerning any disputes. *Id.* at 97a.

B. Abbott Introduces Sevoflurane In The United States And Ohmeda, As Expected, Develops A Generic Competitor.

After obtaining the necessary FDA approval, Abbott began marketing sevoflurane in the United States in 1995. App. 2a. Abbott has enjoyed market exclusivity in the United States ever since, even though it anticipated that generic competition would likely arise by 2000, well before the expiration of the process patents that were licensed to it.

As Abbott had anticipated, a competitor, Ohmeda, by 1997 had developed a commercially viable process for making sevoflurane (the "three-step process") that did not infringe the licensed one-step process. Ohmeda built a pilot plant and prepared plans for a full-scale production facility so that it could, after it obtained FDA approval, compete with Abbott. In April 1998, after Ohmeda had developed the three-step process and its plans to compete, Petitioner acquired Ohmeda.

C. The Parties Enter Arbitration To Determine The Scope Of The Sevoflurane Agreements.

In September 1998, Petitioner informed Maruishi of its intention to pursue Ohmeda's plans to develop and market a non-infringing generic sevoflurane in the United States. When Abbott learned of Petitioner's plan, it invoked the procedures of the Dispute Resolution Agreement. After efforts to negotiate and mediate a resolution failed, Abbott submitted its claim for arbitration.

Abbott asked the arbitrators for an order preventing Petitioner from selling generic sevoflurane until the sevoflurane agreements expire in 2005. Abbott thus asked the arbitrators to impose a covenant not to compete between Petitioner and Abbott with respect to a product that is in the public domain. Such a covenant not to compete would be a *per se* violation of Section 1 of the Sherman Act if it resulted from a direct agreement between the parties. See, *e.g.*, *In re Cardizem CD Antitrust Litig.*, No. 00-2483, 2003 WL 21360049, at *2, *7-*8 (6th Cir. June 13, 2003) (holding that agreement by which brand name manufacturer pays generic seller to keep its FDA-approved generic product off the market is a *per se* violation of the antitrust laws).

During the arbitration, Abbott asserted a variety of bases for the order it sought which, had they been well founded, might have rendered it consistent with the Sherman Act. Abbott claimed that the three-step process would, in fact, infringe the licensed one-step process patents. The arbitrators disagreed. App. 59a. Abbott also claimed that the three-step process was an improvement on the one-step process or that Petitioner had developed the three-step process using know-how derived from the one-step process, thus breaching the exclusive license that Petitioner had granted to Maruishi. The arbitrators also rejected these claims. *Id.*

In sum, the arbitrators expressly concluded that the licensing agreement did not contain the covenant not to compete that Abbott sought. App. 63a-64a. Instead, two of the three arbitrators, over the dissent of the third, determined that they were authorized to impose a covenant not to compete based on the broad authority they were given in the Dispute Resolution Agreement. The majority reasoned, as Abbott had argued, that if Petitioner sold generic sevoflurane, then Abbott would receive less money from sales of its own sevoflurane. Of course, this is only because of the monopoly rents that Abbott could extract by eliminating Petitioner as a competitor. The majority reasoned that the Dispute

Resolution Agreement empowered the arbitrators, even absent a breach of the Baxter-Maruishi licensing agreement,[1] to prevent an "Impairment of the Original Commercial Relationship" by preventing Petitioner from taking any action that would "'reduce the amount [Abbott] would ... otherwise receive'" from its sales of sevoflurane. *Id.* at 61a (emphasis omitted). They thus barred Petitioner from introducing its generic drug in competition with Abbott. *Id.* at 67a.

As is plain, nothing in the *claims* Abbott presented to the arbitrators involved antitrust law. Rather, Petitioner perceived that the order Abbott sought could be deemed an agreement between Petitioner and Abbott (the arbitrators being the mere agents of the parties) to allocate markets in violation of Section 1 of the Sherman Act. Petitioner argued that the order Abbott sought would, therefore, violate the public policy, reflected in the Sherman Act, prohibiting a naked horizontal market allocation. Petitioner also pointed out that the result that Abbott sought would violate the public policy reflected in a Consent Decree that Abbott had entered into with the Federal Trade Commission.[2] As Petitioner explained, the sevoflurane agreements "cannot be interpreted

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[1] The Seventh Circuit panel majority thus erred when it stated that the arbitrators ruled that Baxter's sale of generic sevoflurane would violate the Baxter-Maruishi license. App. 3a. The arbitrators specifically concluded to the contrary, *id.* at 63a-64a, and believed that they were authorized to impose a covenant not to compete even in the absence of a breach of the license agreement. *Id.* at 61a.

[2] In May 2000, Abbott and the FTC entered into a consent decree arising from an agreement between Abbott and Geneva Pharmaceuticals in which Abbott had agreed to pay Geneva $4.5 million per month to delay the introduction of Geneva's generic version of terazosin hydrochloride, a drug for which Abbott was the exclusive, brand-name seller. Pursuant to the terms of the Consent Decree, Abbott must refrain from "being a party" to agreements with generic drugmakers that would keep generic products off the market beyond the point in time at which the FDA would permit them to enter that market. By virtue of the arbitrators' ruling, Abbott is now a party to such an agreement with Petitioner.

in a way [that] violates public policy." Arbitration Hr'g Tr. at 1478, *Abbott Labs.* v. *Baxter Int'l* (CPR Inst. heard Mar. 8, 2001). In one brief paragraph, the arbitrators summarily decided that "no illegality results from" the non-compete covenant they were creating. App. 66a-67a.

D. Federal Court Review Of The Arbitral Award.

Abbott petitioned the United States District Court for the Northern District of Illinois to enforce the arbitral award pursuant to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"). In its response, Petitioner recognized that the fundamental issue of contract interpretation, *i.e.*, whether the Dispute Resolution Agreement empowered the arbitrators to impose a covenant not to compete, could not be reargued. However, because a federal court was being asked, pursuant to the New York Convention, to enforce the arbitral award, the district court necessarily had to decide whether it should refuse to enforce the award because the award is "contrary to the public policy of" the United States. New York Convention, art. V, § 2(b), *reproduced in* 9 U.S.C. § 201 note. Petitioner argued that the award violated the public policy of the United States as reflected in both Section 1 of the Sherman Act and the Abbott/FTC Consent Decree.

The district court did not hesitate to review the public policy question. App. 31a. After conducting its own analysis of the issues, the court concluded – wrongly – that Petitioner had failed to establish either an antitrust violation or a violation of the Abbott/FTC Consent Decree. *Id.* at 31a-39a (antitrust), 39a-40a (Consent Decree).

The Seventh Circuit, by a two-to-one vote, affirmed. Unlike the district court, however, the panel majority flatly refused to consider the merits of Petitioner's challenge to the award as a horizontal market allocation that violated Section 1 of the Sherman Act and the Abbott/FTC consent decree. The panel determined that it had no authority even to reach

Petitioner's public policy argument because the arbitrators had considered and reached their own conclusion on that issue. As the panel viewed the matter, once the arbitrators rejected Petitioner's argument that Abbott's interpretation of the contract would compel unlawful conduct (both under the antitrust laws and the consent decree), a federal court had no choice but to confirm the award. Petitioner could not ask a federal court to refuse to confirm the award, even if confirming the award would effectively order the parties to eliminate competition in a market for an important medical product. App. 4a.

The panel majority acknowledged Petitioner's argument that the arbitrators had *created* and not merely decided an antitrust issue. App. 5a. That is, Petitioner's public policy challenge focused exclusively on the *effect* of the arbitrators' award, and did not challenge the arbitrators' view that the Dispute Resolution Agreement authorized them to impose a covenant not to compete. As the panel majority recognized, Petitioner invoked the rule that prohibits an arbitrator to "command the parties to violate rules of positive law." *Id.* But, to the panel majority, "*whether* the tribunal's construction of the ... agreement has [the effect of commanding the parties to violate the law] was a question put to, and resolved by, the arbitrators. They answered no, and as between Baxter and Abbott their answer is conclusive." *Id.* at 5a-6a. On this basis, the panel majority decided that a federal court could not independently review whether the arbitrators were commanding the parties to violate the law.

Judge Cudahy dissented. Judge Cudahy reasoned that Petitioner's decision to urge the arbitrators not to read the contract to impose an unlawful covenant not to compete did not divest a federal court of authority independently to review the award to determine whether it did command the parties to violate the antitrust laws. Judge Cudahy perceived "an important distinction" between "a simple [antitrust] claim by Baxter against Abbott," on the one hand, and "a request by

Baxter that the arbitrators step back and consider the larger implications of their underlying decision," on the other. App. 12a n.3. Judge Cudahy recognized that a court would surely defer to the arbitrators' ruling in the former situation. *Id.* at 11a-12a.

But this case presented the latter. When the arbitrators examined Petitioner's contention that Abbott's proposed order would be an unlawful covenant not to compete, they were "reviewing their own decision" in precisely the way a court would. App. 13a n.5. Specifically, the arbitrators were examining their interpretation of the Dispute Resolution Agreement to determine whether any "'illegality results'" from the award. *Id.* (citing App. 66a). Judge Cudahy argued that to allow an arbitration panel to insulate its decision from court review through the simple expedient of declaring that its decision does not command the parties to violate the law creates an exception that swallows the rule: "[U]nder the majority's analysis, the rule that unlawful conduct cannot be commanded by arbitrators is consumed by the exception that, if the arbitrators themselves say that what they have commanded is not unlawful, then 'their answer is conclusive.'" *Id.* at 13a.

Judge Cudahy then analyzed the merits of Petitioner's antitrust challenge. Judge Cudahy recognized that an agreement among competitors that, in isolation, reduces competition may be a necessary part of a cooperative venture (like the agreements that brought sevoflurane to the United States) that, on the whole, benefits consumers. App. 15a. But the covenant not to compete imposed by the arbitrators here was not of that sort. It was in no way a necessary part of the agreements that brought sevoflurane to the United States. Competition from Petitioner was not a major concern in 1992, especially after Petitioner had licensed away not only the one-step process, but also any improvements thereon and all of its related know-how. Abbott knew that competition from companies like Ohmeda was on the horizon, and a broad

covenant not to compete from Petitioner would have provided no protection against that. In short, Judge Cudahy could find no reason to believe that Abbott considered a broad covenant not to compete from Petitioner an essential part of the arrangement, especially in light of the fact that Abbott had failed to include any language to that effect in the parties' lengthy and detailed agreements. Thus, Judge Cudahy concluded that the arbitrators' award effects an unlawful horizontal allocation of markets that is not ancillary to any procompetitive agreement. *Id.* at 15a-17a.

Petitioner sought en banc review. By a vote of five to three, the court denied the petition.[3] Judge Ripple issued an opinion dissenting from the denial of rehearing *en banc*, joined by Judges Diane P. Wood and Williams. The dissenters recognized that "the scope of judicial review of arbitral decisions that, at least arguably, order the parties to violate the law is an important issue." App. 93a. Further, the dissent indicated that the panel majority's holding is "difficult to square with existing Supreme Court precedent and, indeed, with the precedent of this circuit and our sister circuits." *Id.*

REASONS FOR GRANTING THE PETITION

The Seventh Circuit's ruling has broken new and unsettling ground regarding the important and recurring issue of court review of arbitral awards. The panel majority's view, that arbitrators have the power to shield their own orders from court review for compliance with the dictates of federal law in general and the Sherman Act in particular, cannot be squared with this Court's precedent, with the precedent of the other federal courts of appeals, with the New York Convention, or with sound arbitration policy. The panel's decision threatens

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[3] Three judges recused themselves from considering the petition. The order denying rehearing en banc lists nine judges, but Judge Cudahy, who served on the panel, is a senior judge and therefore did not participate in the "vote of the active members of the court." App. 92a.

both to discourage arbitration as a means of resolving disputes, thus increasing the burdens on the federal courts, and to undermine the uniform rules defining the boundaries between courts and arbitrators. The Court should grant this petition to preserve the effect of its own prior decisions, to promote the federal policy favoring arbitration, and to ensure a uniform national approach to court review of arbitral awards for compliance with public policy.

1. The Decision Below Is Contrary To This Court's Decisions. Arbitrators have broad discretion to interpret the parties' contract. Parties generally may not ask courts to correct arbitrators' errors of contract interpretation. *United Steelworkers of Am.* v. *Enterprise Wheel & Car Corp.*, 363 U.S. 593, 596-99 (1960). Accordingly, if the arbitrators interpret a contract in a way that requires a party to violate the law or is otherwise inconsistent with public policy, that party may not ask a court to read the contract differently; issues of contract interpretation are exclusively the province of the arbitrators.

But that proposition does not remotely suggest that a party may not ask a court to refuse to enforce the award because it violates public policy. In a series of cases beginning with *W.R. Grace & Co.* v. *Local Union 759*, 461 U.S. 757 (1983), and continuing through *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), and *Vimar Seguros Y Reaseguros, S.A.* v. *M/V Sky Reefer*, 515 U.S. 528 (1995), this Court has addressed that question and recognized that protecting the dictates of public policy is solely the province of the judiciary. In this series of cases, the Court has indicated that arbitrators have the authority to consider, in the first instance, whether one party's interpretation of a contract would violate public policy. But even as these cases permit arbitrators to consider the public policy implications of proposed contractual interpretations, they make clear that, regardless of whether the arbitrator considers the public policy issue, the ultimate authority to ensure that an arbitral

order does no injury to the commands of specific public policies rests with the courts.

W.R. Grace involved a dispute between certain union members and their employer. The employer, Grace, had laid off the union members pursuant to an agreement Grace had with the EEOC regarding past discrimination and its seniority system's effect of perpetuating that discrimination. The agreement with the EEOC was inconsistent with Grace's collective bargaining agreement with its union. 461 U.S. at 760. Grace obtained a district court judgment stating that the terms of the EEOC agreement were binding on all parties, including Grace and the union, regardless of any inconsistency with the collective bargaining agreement. *Id.* at 761. Later the Fifth Circuit reversed and Grace reinstated the laid-off workers.

Pursuant to the collective bargaining agreement, the employees initiated arbitration to collect back pay for the time they were out of work. *Id.* at 762. Grace argued that the district court's order enforcing the agreement with the EEOC precluded an award of back pay, because Grace was complying with that court order during the period for which the employees were seeking back pay. The arbitrator concluded that the collective bargaining agreement did not preclude an award of back pay even if the employees were laid off in compliance with a then-valid court order. *Id.* at 763-64.

This Court refused to reconsider the arbitrator's interpretation of the collective bargaining agreement. *Id.* at 765-66. Thus, this Court accepted that the arbitrator had properly interpreted the contract to require Grace to compensate the employees with back pay, even though Grace was complying with a court order during the relevant period.

Still, this Court reviewed the arbitrator's award for compliance with public policy. It did so because "a court *may not enforce* a collective-bargaining agreement that is contrary

to public policy." *Id.* at 766 (emphasis added). Even though the Court accepted that the arbitrator's reading of the collective bargaining agreement was correct, the Court still independently reviewed the agreement, as interpreted by the arbitrator, to ensure compliance with public policy before enforcing the arbitrator's ruling. Although the arbitrator in *Grace* had not himself considered the public policy question, this Court specifically indicated that it would not have mattered if he had. The arbitrator's "view of his own jurisdiction precluded his consideration of th[e public policy] question, *and, in any event*, the question of public policy is ultimately one for resolution by the courts." *Id.* (emphasis added); see *United Paperworkers Int'l Union* v. *Misco, Inc.*, 484 U.S. 29, 43 (1987) (stating that a decision regarding whether an award violates public policy "turn[s] on *our* examination of whether the award created any explicit conflict with other 'laws and legal precedents'") (emphasis added). Ultimately, this Court found that the arbitrator's ruling was not contrary to public policy and enforced it. But it did so only after reviewing *de novo* the public policy question on its merits. *W.R. Grace*, 461 U.S. at 766-72.

Mitsubishi confirms the approach outlined in *W.R. Grace*. The principal issue in *Mitsubishi* was whether antitrust claims could be submitted to a foreign arbitration panel, and this Court answered that they could. But the United States, as *amicus*, expressed concern that the arbitrators might read the choice-of-law clause (Swiss law) in combination with the forum-selection clause (Japanese arbitration) "wholly to displace American law." 473 U.S. at 637 n.19. The effect of such an interpretation would be that the clauses "operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations." *Id.* Because the arbitration panel had not yet interpreted the contract that way, this Court had no "occasion to speculate on this matter at this stage in the proceedings." *Id.* Nevertheless, this Court made clear that at a later stage in the proceedings, if the arbitrators

in fact read the contract as the United States feared, "we would have little hesitation in condemning the agreement as against public policy." *Id.* The Court cited a variety of cases that stand for the settled rule prohibiting parties by private agreement from releasing each other from antitrust liability arising out of their own agreements. *Id.* Put simply, if the arbitrators, over one party's public policy objection, decided to read the contract as an unlawful prospective waiver of remedies under the Sherman Act, that ruling would not be enforceable by a court.

In *Vimar*, the Court, for a third time, took the same approach to federal review of arbitral awards for violations of public policy. *Vimar* involved a dispute between the owner of a shipload of fruit that had been damaged in transit and the owner of the vessel transporting the fruit. The agreement between the parties required arbitration in Japan. The transaction between the parties was subject to the federal Carriage of Goods by Sea Act ("COGSA"). The fruit owner argued that the Court should not send the case to arbitration because certain Japanese rules, potentially applicable because of the agreement's choice-of-law provision, were inconsistent with COGSA regarding whether the shipowner could defend against the claim based on acts or omissions by the stevedores hired by the shipowner. 515 U.S. at 539.

This Court, acknowledging that the concern was substantial, refused to decide how such a conflict between COGSA and the Japanese rules, if any conflict existed, should be resolved. Instead, this Court held that the arbitrators should consider the question in the first instance. This disposition was justified because court review remained available if the arbitrators ruled both that the Japanese rules applied under the contract and interpreted those rules in a manner inconsistent with COGSA. *Id.* at 540. Relying on *Mitsubishi*, this Court said that the district court would, at the award enforcement stage, have a duty to ensure that that the

construction of the contract and the award are not inconsistent with the public policy reflected in COGSA. *Id.*

In sum, this Court has rejected the outdated suspicion that courts once held for arbitrators. "[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution." *Mitsubishi*, 473 U.S. at 626-27. But the federal policy in favor of arbitration has not led this Court as far as the decision below takes the law: courts abdicating to arbitrators the authority to review awards to ensure that they do not command the parties to violate the law and hence violate public policy. The issue whether the arbitral award so departs from public policy as to be unenforceable remains, under this Court's opinions, the province ultimately of the courts.

All of this produces a simple and sensible approach for dealing with a contract that could potentially be interpreted to violate public policy. The arbitrator should, in the first instance, consider the public policy challenge to a party's proposed contractual interpretation. And, if the arbitrator rejects that challenge and attempts to enforce a reading of the contract that compels a party to violate the law, the courts retain their obligation to consider the public policy challenge on its merits. The Seventh Circuit, in the decision below, refused to hear Petitioner's challenge on antitrust grounds on its merits, choosing instead to give the arbitrators the final word on the lawfulness of their own ruling. At a minimum, the Court should clarify whether its statements in *W.R. Grace*, *Mitsubishi*, and *Vimar* reflect the proper role of the judiciary in enforcing arbitral awards that may violate fundamental public policy norms.

2. The Other Circuits Have Faithfully Applied This Court's Approach To Judicial Review Of Arbitral Awards For Compliance With Public Policy. All the other circuits to have confronted the issue agree that, even if an arbitrator considers

and rejects a public policy challenge to his interpretation of a contract, the losing party has a right to federal court review of the public policy issue at the award enforcement stage. "Once the public policy question is raised, [a court] must answer it by taking the facts as found by the arbitrator, but reviewing his conclusions de novo." *Iowa Elec. Light & Power Co.* v. *Local Union 204*, 834 F.2d 1424, 1427 (8th Cir. 1987); *MidMichigan Reg'l Med. Ctr.-Clare* v. *Professional Employees Div. of Local 97*, 183 F.3d 497, 504 (6th Cir. 1999) ("courts will not enforce a contract that they independently determine [has been interpreted by an arbitrator] to be contrary to public policy"); *Exxon Corp.* v. *Esso Workers' Union, Inc.*, 118 F.3d 841, 845 (1st Cir. 1997) ("the question of what public policy demands is within the judicial, not the arbitral, domain"), *abrogated on other grounds by Eastern Associated Coal Corp.* v. *United Mine Workers of Am., Dist. 17*, 531 U.S. 57 (2000); *Gulf Coast Indus. Workers Union* v. *Exxon Co., U.S.A.*, 991 F.2d 244, 248 n.5 (5th Cir. 1993) ("courts are the ultimate arbiters of public policy, not arbitrators"); *Exxon Shipping Co.* v. *Exxon Seamen's Union*, 993 F.2d 357, 360 (3d Cir. 1993) ("Once we identify a public policy, we must determine whether the arbitrator's award, as reflected in his interpretation of the agreement, violated that policy.").

The issue commonly arises in the labor arbitration context, in which a collective bargaining agreement permits an employer to fire an employee only for "just cause." Each time an arbitrator applies the "just cause" standard to a particular dismissal, he is effectively interpreting the "just cause" language of the contract either to cover or not to cover the circumstances presented. *Eastern Associated Coal Corp.* v. *United Mine Workers of Am., Dist. 17*, 531 U.S. 57, 61-62 (2000). Employers have claimed that reinstating the employee, as the union requests, would interpret the "just cause" language of the contract to require the employer to violate federal safety regulations. And, as the decisions

discussed below from the Second, Ninth, and Eleventh Circuits illustrate, the federal courts consider that public policy issue on its merits, even when the arbitrator has already considered the governing regulations and determined that they did not (or did) require the employer to dismiss the employee.[4]

In *International Brotherhood of Electrical Workers, Local 97* v. *Niagara Mohawk Power Corp.*, 143 F.3d 704 (2d Cir. 1998), an employee of a nuclear power plant had been dismissed by his employer after testing positive for cocaine. An arbitrator "examined at length" the federal regulations the power plant had cited concerning the public policy considerations at issue in the dispute. *Id.* at 709. The arbitrator ultimately ruled against the power plant and reinstated the employee. The power plant challenged the award on public policy grounds, and the Second Circuit independently reviewed the regulations at issue to determine whether they stated a public policy inconsistent with the arbitral award. *Id.* at 715-19.

Southern California Gas Co. v. *Utility Workers Union of America, Local 132*, 265 F.3d 787 (9th Cir. 2001), also involved a utility's dismissal of workers who had tested positive for drugs. The tests were administered pursuant to a federally mandated random testing program. *Id.* at 790. The parties disputed whether the tests had been administered in accordance with the program, and an arbitrator decided that they had not. *Id.* at 792. The arbitrator ordered the employees reinstated. The utility company challenged the award on public policy grounds, referring to a regulation that specifically required the company not to employ individuals

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[4] Indeed, this Court, in *Eastern Associated Coal*, 531 U.S. at 63-67, independently examined the employer's public policy defense to reinstatement even though the arbitrator had considered that issue in the first instance. Brief for Respondents at 3, *Eastern Associated Coal Corp.* v. *United Mine Workers of Am., Dist. 17*, 531 U.S. 57 (2000) (No. 99-1038).

who failed a federally mandated drug test. *Id.* at 795. Given that the arbitrator had already determined that the tests administered by the utility company did *not* comply with federal regulations, the opinion of the panel majority in this case would require a federal court to reject the utility company's public policy challenge without reaching its merits. But the Ninth Circuit, though affirming the arbitral award, specifically conducted its own review of the regulations to determine whether the drug tests had complied with federal requirements. *Id.* at 795-96.

Delta Air Lines, Inc. v. *Air Line Pilots Ass'n, International*, 861 F.2d 665 (11th Cir. 1988), involved the dismissal of a pilot for flying while intoxicated. The pilot was dismissed for violating both airline policy and federal regulations. *Id.* at 668. An arbitration panel reinstated the pilot. As the Eleventh Circuit viewed the arbitral ruling, the panel "ha[d] construed the collective bargaining agreement in such a manner that it appears that Delta has agreed to submit to arbitration the question as to whether it should authorize operation of aircraft by pilots while they are drunk." *Id.* at 671. Despite the fact that the arbitrators had been presented with the various legal bases that the airline asserted reflected a public policy against employment of pilots who have flown while intoxicated, see *Delta Air Lines, Inc.* v. *Airline Pilots Ass'n*, 686 F. Supp. 1573, 1575 (N.D. Ga. 1987), the Eleventh Circuit reviewed those materials *de novo* and found the arbitral award incompatible with public policy. 861 F.2d at 672-74.

The Seventh Circuit, in an opinion by a respected jurist, has stated a position that stands alone and conflicts with a standard of review adopted by the other circuits. This is precisely the situation in which review by this Court is warranted.

3. The Decision Below Threatens Effectively To Nullify The Public Policy Exception To Enforcement Of Arbitral Awards And Reflects Poor Arbitration Policy. The approach set forth

in *Grace*, *Mitsubishi*, and *Vimar*, and followed by the other circuits, should have led the Seventh Circuit to consider on its merits Petitioner's argument that the arbitral award was grossly anticompetitive and therefore that the interests of consumers required that it not be enforced. In accord with the approach outlined in these cases, Petitioner first tried to persuade the arbitrators that Abbott's proposed interpretation of the Dispute Resolution Agreement would cause the parties to violate the antitrust laws and Abbott to violate its consent decree with the FTC.[5] When the arbitration panel accepted Abbott's interpretation over Petitioner's opposition, based in part on public policy, Petitioner, again following the approach outlined above, asked the district court to "condemn[] the agreement as against public policy." *Mitsubishi*, 473 U.S. at 637 n.19.

The court of appeals rejected the course detailed by existing caselaw. Instead, the panel majority relied on the general, but here inapplicable, rule that when arbitrators decide antitrust claims, a court's review is limited. App. 4a-5a. That is certainly true when the parties have agreed to arbitrate an antitrust *claim*, seeking affirmative relief, brought by one party against another. *Mitsubishi*, 476 U.S. at 628-40. But that rule is not implicated when the antitrust issue is presented

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[5] Just this past April, this Court, in *PacifiCare Health Systems, Inc.* v. *Book*, 123 S. Ct. 1531 (2003), indicated that an arbitrator should be permitted, in the first instance, to consider whether an arbitration clause in a contract that prohibits the award of punitive damages in arbitration would prohibit the arbitrator from awarding treble damages under RICO. Nothing in *PacifiCare* suggests that submitting the issue to the arbitrator in the first instance would prevent a court, at the enforcement stage, from determining whether an arbitral decision to refuse to award treble damages based on the contract's prohibition on punitive damages violates public policy by frustrating the remedial purposes of RICO. If the Seventh Circuit's ruling stands, then *PacifiCare*'s rule requiring an arbitral ruling in those circumstances ensures that no court will be permitted to reach the underlying RICO issue.

as a public policy-based *defense* against the opposing party's proposed construction of a contract.

When raised as a *defense*, as Petitioner has done here, the antitrust issue presents a question within the well-settled meaning of the public policy exception to enforcement of arbitral awards: a court should not enforce an arbitral award that commands a party to violate the law. *Eastern Associated Coal*, 531 U.S. at 63; *Misco*, 484 U.S. at 42; *W.R. Grace*, 461 U.S. at 766. If Petitioner is correct, then the Dispute Resolution Agreement as interpreted by Abbott and the arbitrators violates the Sherman Act and an FTC consent decree. In turn, the arbitral award enforcing that agreement commands Petitioner to violate the Sherman Act. There is no similar possibility of a command to violate the law when the parties arbitrate an antitrust *claim*. Even an erroneous ruling that permits anticompetitive conduct to continue does not *compel* any violation of the law; it merely *permits* it.

The panel majority read *Mitsubishi* expansively to require courts to defer not only to an arbitrator's ruling on an antitrust *claim*, but also to an arbitrator's ruling that his own order does no violence to the antitrust laws. The panel found support for this expansive reading in the general rule that courts have only limited authority to review an arbitrator's ruling for legal errors. App. 4a. If allowed to stand, this line of analysis will vitiate the public policy exception in its entirety. As this Court has made clear, a party may seek to prevent enforcement of an arbitral award for violating public policy only when the policy is "well defined and dominant, and ... ascertain[able] 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.'" *W.R. Grace*, 461 U.S. at 766. That is, public policy is revealed entirely through traditional materials of positive law – statutes, regulations, and court precedents. *Eastern Associated Coal*, 531 U.S. at 63. If courts must always defer slavishly to arbitrators' analyses of positive law, even in the context of public policy challenges to arbitral

awards themselves, then there is nothing left of the public policy exception, which is supposed to restrict an arbitrator's power. The panel majority's analysis thus has the effect of reading the public policy exception to enforcement of arbitral awards out of the New York Convention. New York Convention, art. V, § 2(b) (stating enforcement should be refused where "recognition or enforcement of the award would be contrary to the public policy of [the court's] country"), *reproduced in* 9 U.S.C. § 201 note.

Thwarting the public policy exception to enforcement of arbitral awards is not only contrary to the New York Convention and the precedents discussed above, but is also unsound arbitration policy. As an initial matter, because arbitration agreements are contracts, they should be interpreted and applied consistent with the parties' intent. *EEOC* v. *Waffle House, Inc.*, 534 U.S. 279, 294 (2002). It is hardly reasonable to assume that parties intend to insulate from judicial review not only the arbitrator's interpretation of the contract, but also an order that compels a violation of positive law.

Further, this Court repeatedly has emphasized the federal policy favoring arbitration of disputes. *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991); *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). Arbitration provides a speedy and efficient means of resolving disputes, and helps relieve the burden on the court system. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). Depriving a party of the opportunity to obtain court relief if an arbitrator's erroneous legal analysis leads the arbitrator to order that party to violate the law places an added cost, a potentially large cost, on every arbitration clause: the potential for an unreviewable order to violate the law. As the panel majority itself recognized, while Petitioner and Abbott are bound to respect the arbitrators' conclusion that the arrangement is lawful, others are not. App. 5a-6a. Either or both of Petitioner and Abbott are, as a

result of the arbitral ruling which the Seventh Circuit has deemed unreviewable, exposed to potentially costly antitrust suits. This additional cost can serve only to discourage use of the arbitration process by contracting parties, contrary to the federal policy favoring arbitration.

* * * *

A badly divided Seventh Circuit has staked out a provocative position concerning the relationship between arbitrators and courts with respect to the protection of public policy. Notwithstanding prior statements of this Court indicating that such issues are ultimately for the courts to decide, the court below concluded that judicial deference to arbitration decisions extends even to determining the validity of those decisions measured against the demands of public policy. Other circuits would not have refused to consider Petitioner's antitrust arguments on their merits. Indeed, the ruling below renders impotent the command of the New York Convention not to enforce awards that conflict with public policy, and the ruling will undercut the willingness of contracting parties to opt for arbitration. The court of appeals has cried out for this Court to review its decision; the Court should accept that invitation.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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July 2, 2003

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